

December 11, 2003

Honorable Mayor and Members
of the City Council
City of Taylor
23555 Goddard Road
Taylor, MI 48180

Dear Mayor and Council Members:

We have recently completed our audit of the financial statements for the City of Taylor for the year ended June 30, 2003. As a result of our audit, we offer the following observations and comments for your consideration:

OVERVIEW OF THE CITY'S FINANCIAL CONDITION

The General Fund fund balance at June 30, 2003 decreased to approximately \$4,233,000 of which \$1,939,000 has been reserved. The unreserved portion of fund balance represents approximately 5 percent of 2003 expenditures. In the coming years, the City will continue to face future revenue reductions as the State's economic growth and associated revenue sharing payments decline. In addition, along with the recurring operating expenditures, we understand that, starting in fiscal year 2004, the City will also need to make significant employer contributions to its General Employees Pension Plan. As the City is well aware, it continues to be critical to maintain a sufficient level of fund balance to be able to adjust to expected and unanticipated financial changes, such as you are currently experiencing. An adequate level of fund balance positions the City to address negative financial changes without disrupting the level of services provided to citizens or the City's ability to fund future obligations. We understand that the City has been taking a proactive approach in addressing these financial concerns. The City, among other things, has initiated departmental across-the-board cuts, has limited or frozen hiring and has also implemented co-pays for healthcare. Mayor and Management must continue to closely monitor City financial activities to achieve budgeted results and plan for improving General Fund fund balance levels over an established future timeframe.

NEW FINANCIAL STATEMENT FORMAT

Over the last several years, we have been discussing with you the new accounting standard that will significantly impact the format of the City's financial statements. This new standard, Governmental Accounting Standards Board (GASB) Statement 34, is now here! You will notice a very different look to the financial statements this year. Preparing for this new reporting model has been a long and arduous process for the City's finance department. The information that was previously provided in your financial statements has been retained in the new financial statement format. In addition, the following major items have been added:

NEW FINANCIAL STATEMENT FORMAT (continued)

- *Management Discussion and Analysis:* Management now provides a narrative overview of the City's overall financial position and results of operations in the annual financial report.
- *Government-wide Financial Statements:* These additional statements adjust the normal fund-based statements into a combined, full-accrual format. This allows a financial statement reader to see the City from a longer term perspective (i.e. are today's taxpayers paying the full cost of today's services?). These statements show capital and infrastructure assets, as well as long term debt as part of the City's financial picture.
- *Budget Comparison:* A financial statement reader will now be able to view not only the actual revenue and expenditures of the City as compared to the amended budget, but also as compared to the original budget.

While getting used to the new format may take a while, the Management's Discussion and Analysis section of the new reporting format, as mentioned above, provides an overview of the City's finances, and highlights the significant financial events of the fiscal year.

We would be happy to discuss any questions you may have about the new statements and how to best interpret the information provided.

STATE SHARED REVENUE

The City has and will continue to feel the effects of the slow down in the State's economy. State shared revenue accounted for approximately 20% of the City's total General Fund revenue for fiscal year ended June 30, 2003. Because of slower than anticipated growth in the State's sales tax collections (the sole source of revenue sharing payments to local units of government) and the State's budget problems which have resulted in additional appropriation reductions to the revenue sharing line item in the State's budget, revenue sharing payments for the State's fiscal years ending September 30, 2002 and 2003 were less than originally projected.

The recent Governor's Executive Order 2003-23 lowered the appropriation for statutory revenue sharing an additional \$72 million. Supplemental legislation will be required to update the current formulas in statute to reflect the lower appropriation. Under existing law and the October 2003 Consensus Revenue Estimates, fiscal year 2003/2004 revenue sharing payments would be 4.2% lower than the 2002/2003 level. The Executive Order increases that decline another 5 percent, to 9.2%. Local units receive revenue sharing under both the statutory and constitutional provisions; that estimate is based on a reduction of the combined total.

As you have already been made aware, the City of Taylor's forecasted revenue sharing for fiscal year 2003/2004 is approximately \$8,307,000. The impact that these cuts in revenue sharing by the State have had on the City resulted in a reduction in revenue sharing of approximately \$1,883,000 between fiscal year 1999/2000 and fiscal year 2003/2004..

It is generally acknowledged that the State's budget woes will continue for several more years. As a result, we continue to urge the City to be conservative in its estimation of state shared revenue as this line item in the State's budget remains vulnerable.

PROPERTY TAXES

As you recall, Proposal A limits the growth in taxable value to the lesser of inflation or 5 percent. The inflation factor for this calculation is published by the State Tax Commission and is as follows:

2004	2.3%		
2003	1.5%	1998	2.7%
2002	3.2%	1997	2.8%
2001	3.2%	1996	2.8%
2000	1.9%	1995	2.6%
1999	1.6%		

The 2003 inflation factor, which is the lowest level of inflation in the last ten years, is being used for property taxes levied in the City's fiscal year ended June 30, 2004. Property taxes are the City's largest source of General Fund revenue. However, as indicated above, growth in existing property are significantly limited due to Proposal A. The City has been very cognizant of this inflation factor and the limit it imposes on the City's ability to increase revenue. The City has used this factor in its annual planning process and in contract negotiations. This factor should continue to be considered especially when the City is involved in any long-term financial planning.

The Headlee Amendment to the Michigan Constitution limits the amount of taxes that can be levied by the City. In general terms, if growth on the City's existing property tax base exceeds inflation for a particular year, the Headlee Amendment requires the City to "roll back" its property tax rate to inflation. Prior to the passage of Proposal A in 1994, during years when the growth on the City's existing property tax base was less than inflation, the Headlee Amendment allowed the City to "roll up" its property tax rate and recover from years when the property tax rate was "rolled back". However, subsequent to the passage of Proposal A, the City is no longer allowed to "roll up" its property tax rate in years when growth on its existing tax base is less than inflation. For the year ended June 30, 2003, the City's Headlee maximum property tax rate for its operating levy was 8.57 mills even though City Charter would allow the City to levy 9.5 mills for operations. Essentially, this limitation on property tax millages has effectively reduced the charter operating millage by approximately \$1.1 million. As indicated, due to the passage of Proposal A, the City cannot "roll up" to 9.5 mills, without a vote of the citizens to override the Headlee Amendment.

GENERAL ACCOUNTING ITEMS

Ticket Control – Police Department and District Court

We have previously discussed ticket control procedures with representatives from public safety and the District Court. In addition, it is our understanding that procedures were previously initiated between the Court and Police Department whereby the ticket log books would be regularly reconciled between the two entities. We strongly encourage the Police Department

and the Court to actively and timely employ these procedures to provide adequate controls such as the following:

- Supervisory approval of ticket sequence issuance when an officer takes a book of tickets from the store room.
- Reconciling the ticket activity log book maintained at the Police Department to the Court files
- Adequate and timely follow-up procedures to identify and account for all missing tickets

City Utilization of Credit Cards

City Council authorizes the use of a credit card arrangement for the purchase of goods and/or services solely for the official business of the local unit under the guidelines of the City's written credit card policy. The written policy stipulates that all credit card limits should be no more than \$2,000. However approximately one half of the credit card statements have credit limits ranging between \$5,000 and \$7,000. We encourage the City to either amend the credit card policy to reflect the actual credit limits or reduce the limits on the cards to comply with City policy.

Fixed Asset Records

With GASB 34 now fully implemented, it is essential that the City continue to track and record all capital asset activity along with the related depreciation on an annual basis. The fixed asset listing was thoroughly reviewed and updated by a third party service provider and City personnel in the current year. Going forward, the City should continue to contemporaneously keep a detail list of acquisition and disposition activity during the year utilizing the new software provided by the appraisal firm. This will streamline the effort needed by the City to report their capital assets in the annual financial statements and assist with capital budget and property insurance planning.

We noted during our audit of the City's fixed asset listing for governmental activities that numerous additions under the capitalization threshold of \$5,000 were capitalized in the current year. This listing included several items under \$500, which is well below the capitalization threshold. There are times when the City should be capitalizing items below the established threshold; for example, when the City purchases capital assets that are individually below the threshold, but aggregately significant or if the City would like to use the listing as an asset control (such as to track palm pilots, printers, fax machines, etc.) However, purely for efficiency reasons, small capital assets under \$5,000 purchased individually that do not need to be tracked for asset control purchases (such as wood signs) probably should be expensed. We recommend, where appropriate, that the City adhere to their capitalization policy.

Police and Fire Retirement System

In the course of the audit of the Police and Fire Retirement System, we noted a few occasions where new retirements were filed, but not formally approved by the Board, or not documented in the board minutes as approved. The Board should be formally approving all retirements and documenting that approval in the Board minutes.

General Employees Retirement System

The City, at this point, does not have in place a fully functioning retirement board to serve its General Employees Retirement System. Although a pension board does exist, its role is primarily limited to investment related matters. Therefore, the general employees retirement system currently has no procedures in place to formally approve the determination of benefits or the calculation of new retirees' benefits. Neither this board nor the City approves the above determinations. However, we do understand that the H.R. Department at the City is now performing these calculations with assistance from Gabriel Roeder. Additionally, retirees' checks are not approved. We recommend that a review process for the benefit calculations be put in place to ensure the appropriate liability is recorded and create an formal approval process to verify the accuracy of benefit payments to retirees.

The City's personnel department has recently taken over the calculation of employee reserves for this system. As the City transitions this responsibility in full to that department, it may be beneficial to review current processes and determine what, if any, additional accounting or procedural items should be done to enhance the internal control system related to the plan. During the audit, we noted that there is currently no annual reconciliation being performed which agrees actual calendar year contributions from the accounting records to the contributions used in the calculation of the employee reserves. In addition, the City may want to ensure its employee reserve reconciliation procedures reconcile the total of all pension contributions for the year as well as the ending reserves to the sum of all the employee worksheets that are being used to track the reserves on an individual employee basis.

Presently, the General Employees Retirement System does not receive an annual consolidated fund manager investment statement from Merrill Lynch. To assist with recording the financial activity, we recommend the City request a consolidated investment statement from Merrill Lynch.

Remote Location Receipts – Internal Controls

Despite the fact that most municipalities have formal internal control policies governing cash receipt procedures, it is common for these procedures to not be fully implemented at cash receipt locations outside of the main municipal campus. We noted several instances where cash receipting internal controls at remote cash receipting locations could be enhanced, as follows:

Sportsplex

The internal control procedures at TSX has improved over the last year. The management at TSX has been very receptive to making necessary changes. Currently, checks received at the Sportsplex are not restrictively endorsed until cash is reconciled by the cash manager. We recommend each register utilize a restrictive endorsement stamp upon receipt of each check.

Parks and Recreation Department

It appears that the current cash receipting system used by Taylor's Parks and Recreation department does not have an overall system to ensure the completeness of cash receipts. The

Parks and Recreation facility and the Petting Farm utilize pre-numbered cash receipts; the pools and other facilities use cash registers for receipting. Presumably, the cash registers will allow staff to print out receipt totals on a daily basis that can be reconciled to the total actual receipts (similar to z-tape capabilities).

The pre-numbered receipt forms used at the Parks and Recreation facility and the Petting farm are separate books. The manager of Parks and Recreation does not review the two separate series of receipts to ensure that the sequence is complete and that it agrees with the beginning and ending receipts per the logs. Additionally, the treasurer's office does not receive copies of the receipts to reconcile to the cash summary report. We recommend the following:

- Utilization of pre-numbered receipts at all remote locations that are offering Parks and Recreation services or utilization of receipting registers that have z-tape (or similar) capabilities
- Independent verification of pre-numbered cash receipts sequences
- Remitting of remote location pre-numbered receipts or z-tape with the cash summary reports to the Treasurer's office for reconciliation

The implementation of these additional procedures will help to protect against possible misappropriation of funds.

Property Tax Receivables

During our audit, we noted that the City's accounting system does not track delinquent personal property taxes by tax year. Efforts should be made to determine the year of the delinquency and, certain receivables, generally those greater than 5 to 7 years old, should be written off. Annually, the accounting records should be reconciled to the treasurer's office to ensure propriety of the amounts recorded.

Payroll Accruals

The current system for tracking payroll, the AS/400 system, does not accurately track employees' vacation, sick and bonus hours. As a result, the City has been using an excel spreadsheet to manually track the hour banks. The City's H.R. department has gone through an extensive process over the last several years to verify each person's banks in order to get it entered into a system that will result in weekly tracking. We understand that the City is moving toward the implementation of a new program which will allow for a more automated process in this area. We commend the H.R. department on its significant efforts thus far and strongly encourage the City to continue to move forward in this direction. A time system that is closely tied into the City's payroll system, will, eventually eliminate this manual process

Other Internal Controls

Bank reconciliations

We noted that the Water and Sewer department did not receive cancelled checks from its bank for the main checking account from July 2002 through November 2002. We understand that part of the reason for this initially was due to a change in banks, and was not noticed on a timely

December 11, 2003

basis due to a slight lag in preparing the monthly bank reconciliations after the year end close. Because bank reconciliations are the primary internal control over cash, future reconciliations should be prepared on a timely basis. Bank errors and other such problems could then be handled in time to deal more effectively with them.

In addition, there is currently no formal independent review of the City's bank reconciliations on a monthly basis. Typically, the City's procedure calls for an independent review only on an exception basis (ie. when the preparer has a question). A strong internal control system over cash would provide for a review of the reconciliation on a monthly basis by someone outside of the cash receipting and bank reconciliation preparation functions. Both the preparer and the reviewer should be signing off on the reconciliations as evidence of the work performed. The City should review its policies in this area and consider providing for these additional controls.

MUNICIPAL FINANCE ACT REVISIONS – REMINDER

The Municipal Finance Act was amended during 2001. Beginning after March 2002, communities are now required to submit a filing once a year with the Michigan Department of Treasury. The old ten day "exemption from prior approval" process has been eliminated and is replaced with this qualification process. This filing will serve as a pre-approval for future debt issues. The current filing is due within six months of the City's year end (which means for Taylor that filing is due December 31, 2003) and is good for one year thereafter.

We would like to thank Mayor Pitoniak, Mr. Philo, and the entire Budget and Finance and Treasury Department staff again for their cooperation and assistance they provided during the audit. We would be happy to answer any questions or concerns you have regarding the annual financial report and the above comments and recommendations at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



Douglas G. Bohrer



Michelle M. Watterworth